



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	02/26/99	Bill Number:	SB 1222
Tax:	Sales and Use, Special, and Property Taxes	Author:	Knight
Board Position:		Related Bills:	AB 436 (McClintock), AB 572 (Pescetti), AB 1631 (1998) SB 1425 (1998), SB 1478 (1998)

BILL SUMMARY:

This bill would require that any state agency that collects taxes, including the Franchise Tax Board (FTB), the Board of Equalization (BOE), and the Employment Development Department (EDD), not the taxpayer, shall have the burden of proof in any court or administrative tax proceeding with respect to any factual issue relevant to ascertaining the tax liability of a taxpayer, under certain circumstances.

ANALYSIS:

Current Law:

As a general rule, in civil cases involving the potential loss of money or property, the burden of proof is on the party in control of the facts. California law provides that taxpayers seeking relief, like plaintiffs in other civil actions, have the burden of proving that the government's action was incorrect and establishing the merits of their claims by a preponderance of the evidence. The burden of proof is placed on the taxpayer since that is the party who has control of the records and documents. It has been established in *Welch v. Helvering* (1933) 290 U.S. 111, 115 that the ruling of the taxing agency has the support of a presumption of correctness, with the taxpayer having the burden of proving it wrong. By contrast, in criminal cases involving the potential loss of liberty or even life, the burden of proof is on the government.

Under current Sales and Use Tax Law (and the other various tax and fee laws administered by the Board of Equalization), upon filing a return, a taxpayer may be requested to furnish additional substantiation of items reflected on their return, or as the result of an audit, be requested to pay additional taxes or be eligible for a refund. In a sales tax audit, for example, the auditor wants to determine the following about the returns that are filed: (1) Have all gross receipts from sales of tangible personal property and taxable labor and services been reported; (2) Has the cost of all business equipment and supplies that were purchased without tax, either from out-of-state vendors or for resale, been reported; (3) Were deductions properly claimed; (4) Were local taxes properly allocated; (5) Was the correct rate of tax used; and (6) Was tax properly applied to sales and use of tangible personal property.

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BOE auditors may attempt to verify certain information reported on taxpayer tax returns. Where an audit discloses that the taxpayer has underpaid tax (or if the BOE otherwise determines that the taxpayer owes additional amounts), the taxpayer will be sent a billing called a *notice of determination*.

A taxpayer who disagrees with the BOE's determination of amounts owed may file an appeal, called a *petition for redetermination*. During the audit and petition process, the auditor and appropriate BOE staff will review all the taxpayer's contentions, including any substantiating evidence submitted in the form of books and records or other documentation. If BOE staff confirm the legitimacy of the assessment, a *notice of redetermination* will be issued, unless the taxpayer requests either a Board hearing or appeals conference, which provides the taxpayer another opportunity to present material in support of their position. At the appeals conference or hearing, taxpayers may present facts and material in support of their position. After that hearing, the Appeals Section representative will prepare a *decision and recommendation* (D&R), containing an analysis, conclusion, and recommendation for the case. If the taxpayer disagrees with the D&R, the taxpayer may request a hearing before the Board Members (Board).

A Board hearing is typically not granted until all other opportunities for resolution are exhausted, so that every attempt to resolve cases at the lowest possible level is afforded. In the event of a final adverse Board decision, the taxpayer may then pay the amount of the determination and file a claim for refund. If the Board denies the refund claim, then the taxpayer may bring action against the state in Superior Court. In litigation, as with appeals, there is a rebuttable presumption that the government's action was correct.

The taxpayer's forum for appealing a FTB or BOE action on a protest is with the Members of the Board of Equalization (Board). The five elected Board Members serve as the appellate body in final actions of the FTB and BOE. In the independent review by the Board, there is a rebuttable presumption that the FTB or BOE action was correct. Hence, taxpayers have the burden of proving that the action was incorrect and establishing the merits of their claims by a preponderance of the evidence. In the event of a final adverse Board decision, the taxpayer may bring action against the state in Superior Court. In litigation, as with appeals, there is a rebuttable presumption that the government's action was correct.

Background:

Dick Bros., Inc. v. Comm. (CA3 1953) 205 F2d 6 established that the taxpayer has the burden of going forward with evidence to rebut the presumption. Placing the burden of proof on the taxpayer means that the taxpayer must affirmatively provide information and/or documentation to prove that he or she is entitled to, for example, a claimed deduction. In other words, there is no presumption that he would not have claimed a deduction to which he was not entitled.

The BOE administers 27 tax and fee programs. In sales and use tax matters, the burden of proof is on the taxpayer, not only to demonstrate that a BOE determination is

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incorrect, but to produce evidence from which a proper tax determination can be made. The taxpayer cannot simply assert that the BOE made an error and shift the burden to the state to prove otherwise. See *Paine v. State Board of Equalization* (1982) 137 CA3d 438.

H.R. 2676 (Archer, et al.) which is known as the “Internal Revenue Service Restructuring and Reform Act of 1998,” was signed into law in 1998. This bill contains several provisions under the title Taxpayer Protection and Rights. Under these provisions, the burden of proof would shift to the IRS for ***court proceedings only***.

Proposed Law:

This bill would require that any state agency that collects taxes, including the FTB, the BOE, and the EDD, not the taxpayer, shall have the burden of proof in any court **or** administrative tax proceeding with respect to any factual issue relevant to ascertaining the tax liability of a taxpayer, if the taxpayer has (1) asserted a reasonable dispute with respect to an issue or issues; and (2) fully cooperated with the state agency with respect to those issues, including providing, within a reasonable period of time, access to or inspection of all witnesses, information, and documents within the control of the taxpayer, as reasonably requested by the state agency. This bill would apply only to legal actions that are filed in connection with tax disputes that arise on or after the operative date.

Similar Bills:

Several bills were introduced during the 1997-98 Legislative Session that addressed the burden of proof issue, but none were sent to the Governor. Those bills, authors, and the Board positions included: AB 1631 (Sweeney, et al.) – Neutral, point out problems, SB 1425 (Hurt, et al.) – Neutral, and SB 1478 (Rainey) – Neutral, point out problems. This bill is identical to the introduced version of SB 1478.

COMMENTS:

1. Purpose of the bill: The author is the sponsor of this bill. According to the author’s office, the purpose of this bill is to promote taxpayer fairness.
2. There are valid reasons why the current burden of proof standard falls on the taxpayer, not the administrative agency. The needs for the current burden of proof requirement include the likelihood that the taxpayer would have access to the relevant information and the desirability of bolstering the record-keeping requirements of the law (*U.S. v. Rexach* (CA1 1973) 482 F2d 10).

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3. This bill is not in conformity with the new federal burden of proof requirements. In order to be consistent with the new federal provisions of the IRS Restructuring and Reform Act of 1998, the burden of proof should shift to the state at the court level only, after all administrative remedies have been exhausted, as specified in H.R. 2676.
4. The definition of a fully cooperating taxpayer is too broad. The bill provides that the burden of proof lies with the state if the taxpayer “fully cooperated” with the state agency by providing access to or inspection of all witnesses, information, and documents within the control of the taxpayer. Therefore, if witnesses, information, and documents are not “within the control of the taxpayer,” either by reason of the taxpayer’s carelessness or a deliberate act, the taxpayer would not be required to provide them yet would still be considered to be fully cooperating.
5. The bill does not define “administrative tax proceeding.” Although administrative tax proceeding is not defined, this bill would shift the burden of proof at the administrative tax proceeding level. Absent a definition, one might claim the administrative tax proceeding begins at several different levels; from the time a taxpayer files a return, when an audit begins, when a petition is filed, or when a Board hearing is commenced. The lack of clarity would make the BOE’s administration of the tax laws very difficult. In contrast, the IRS Act only applies to court proceedings after administrative remedies have been exhausted.
6. The language should clarify the effective date for specific circumstances. The language should include provisions that specify the circumstances under which the burden of proof would shift. Currently, the bill would apply to legal actions filed in connection with tax disputes that arise on or after the operative date. Legal action is not defined by the bill. Also, it is not clear what point in the process a tax dispute would arise; when the return is filed, when a petition is filed, when a Board hearing is commenced? (See Comment 5). Does the operative date relate to the date the tax dispute first arose or the date a legal action is filed in connection with the tax dispute? If the shift in the burden of proof applies only to court proceedings, the language should state that the shift in the burden of proof would occur for all court proceedings in connection with determinations issued on or after the operative date.
7. Shifting the burden of proof at the administrative level could result in additional record-keeping and administrative requirements. The taxpayer is in control of the records and documents related to his or her tax return, and the current burden of proof requirement reflects this practice. If the burden of proof shifts to the Board at the administrative level, the taxpayer may have little or no incentive to maintain accurate documentation, and the Board would thus be burdened with attempting to reconstruct the documents. This would make the audit and petition process much more difficult to manage and could result in more time-consuming audits involving third-party interviews, credit report requests, review of other agencies’ returns, and/or searches for any available relevant documents maintained by the taxpayer or others.

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8. This bill may lead to a more formalized hearing process. The current administrative review process is performed without extensive evidentiary rules, which is designed to provide an environment that lessens the need for professional representation. However, if the burden of proof is shifted, a more formal process may be necessary in order to produce substantial evidence and establish whether a taxpayer was cooperating.
9. This bill may create burdensome record-keeping requirements for taxing agencies. To ascertain the tax liability of a taxpayer, this bill could require that all state taxing agencies maintain large, costly taxpayer files for periods beyond the regular statute of limitations.
10. It would be extremely confusing to taxpayers if California's burden of proof requirements were different than the federal requirements. Therefore, the Legislature may wish to consider conforming to the burden of proof provisions in the IRS Restructuring and Reform Act of 1998.

COST ESTIMATE:

This bill would result in additional costs to the Board, to the extent that additional supporting evidence would be required on all cases to support the state's position. An estimate of these costs is pending.

REVENUE ESTIMATE:

If this legislation leads to reduced reporting, departmental audit programs would be adversely impacted, resulting in lost revenues. While the total magnitude of the loss is not known, as a point of reference, total revenues collected by the Board in 1996-97 were \$31.3 billion. Of that amount, sales and use tax revenues were \$26.3 billion, gasoline tax revenues were \$2.5 billion, cigarette and tobacco tax revenues were \$700 million, and diesel fuel revenues were \$400 million.

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